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The Economic Implications Of France Under Mitterrand

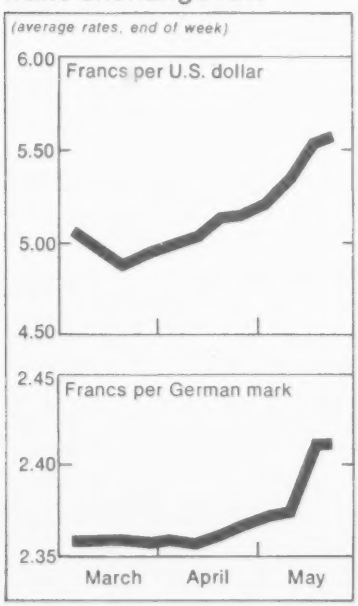
The election of French President Francois Mitterrand breaks with 23 years of conservative rule during the Fifth Republic. Clearly, the outcome will have a major impact on the course of economic development in France, although the full implications may not be clarified until the National Assembly elections are concluded. Mitterrand was elected on the basis of a comprehensive economic program that includes: reflation, extensive nationalization, increased minimum wages and social welfare payments, overhaul of the tax system, and a shorter working week. The overall aim is to boost economic growth to 3% per annum in real terms. Mitterrand's program reverses the policy of recent years under the "Barre Plan," bringing back to the fore Keynesian demand-management techniques as a means of restoring full employment. It also contrasts with the restrictive policies pursued by nearly all other Western industrial nations.

In the short run, the Mitterrand victory is likely to have little impact on the course of the economy. However, the first part of Mitterrand's program —higher minimum wages and family allowances—has already taken effect. These measures were not contingent on the results of the National Assembly elections and will boost economic growth in the second half of the year. Over the longer run, reflation will take the form of a consumer boom and show up in a widening budget deficit. This will enlarge the French current-account deficit and may lead to higher inflation, depending on the monetary stance of the new administration.

Fear of reflation has undermined confidence in the franc, which has been trading consistently at its floor within the European Monetary System in terms of the German mark. The spectre of devaluation has prompted a sharp rise in short-term interest rates to quell speculation. The discount rate on Treasury bills (the official intervention rate) has been raised to a record 22%, and call—or day-to-day—money now stands at 20%, also a record. A tightening of exchange controls on "leads" and "lags" in trade payments was also announced to supplement higher interest rates.

Should dollar strength prompt a renewed tightening of monetary policy in Germany, a temporary tactical withdrawal of the franc from the EMS may be deemed necessary. In any event, a downward adjustment in franc intervention limits vis-à-vis the mark, as part of a general realignment in EMS parities, is likely following the National Assembly elections. In the interim, speculation will be countered with continued high interest rates, and, possibly, a further tightening of existing capital controls.

Movements in the franc exchange rate



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Further adjustment to higher oil prices needed in Sweden.

Recent political problems have delayed Sweden's adjustment to high energy prices. The policies introduced several months ago, however, have given the authorities some reprieve. They have reduced domestic demand generally, and the resultant falls in consumption and industrial output have helped reduce consumption of oil. Crude oil imports are down 18% from last year, which has given Sweden a $26-million trade surplus for 1981 to date, compared with a deficit of $54 million for the same period in 1980. The government has revised its forecast for the 1981 current-account deficit down to 19.6 billion kronor ($3.9 billion, at current exchange rates) from kr. 22.8 billion ($4.6 billion), and the authorities now expect to borrow the equivalent of 20 billion kronor from abroad, versus the kr. 25 billion originally planned on. Further adjustment, however, is still needed. The improved trade balance owes more to reduced imports than to a favorable export trend; indeed, exports are still 5% lower than a year ago. In addition, the high rate of inflation and its impact on indexed earnings remain far too high for comfort.

Norway's oil boom a mixed blessing.

Norway's booming oil sector continues to pose problems for the domestic economy. Large wage increases in the oil sector have spilled over to other labor-market sectors. And after reaching 13.7% at the end of 1980, the rate of inflation has climbed further, pushing the April price index 14.6% above its year-earlier level. Price and cost increases have hurt competitiveness in the traditional industries, and the government is under pressure to provide heavy subsidies to keep unemployment down to its present level of just below 1.5%. The benefits of Norway's oil boom are, of course, most evident in the external sector. Oil export earnings contributed to a $33-million trade surplus in April, bringing this year's cumulative surplus to $85 million, compared with $1 billion for the year-earlier period.

Finnish GDP growth slowdown forecast, but pace will stay one of highest in the West.

The worldwide recession is beginning to impinge on Finland's economic performance. Higher-cost oil imports, a weakening export showing, and increased debt service have widened the Finnish current-account deficit, which is projected to rise to $1.7 billion this year from $1.3 billion in 1980. Partly as a result of the export slowdown, 1981 real GDP growth of only 2.5% is forecast by the OECD, compared with growth of nearly 5% in 1980. Inflationary pressures, however, have been strong for some time, and consumer prices are likely to rise by 12% this year. Nonetheless, the overall picture is far from gloomy. Finnish economic growth this year will remain among the fastest in the West—for the third year in succession. And as time passes, the economic slowdown will have a beneficial effect on inflation and on the balance of payments. The OECD currently forecasts both a drop in the inflation rate to 9.75% in 1982 and a narrowing of the current-account deficit to $1.1 billion.

Indian GNP growth rebound accompanied by widening external-account deficit.

India's inflation-adjusted GNP advanced by an estimated 6.5% in fiscal 1980-81 (ended March 31), after contracting by 4.5% in fiscal 1979-80. Foodgrain production rebounded to a record 133 million tons from 109 million tons in 1979-80, and overall agricultural output rose 19%, the result of a favorable monsoon. At the same time, industrial output expanded by an estimated 4% as the number of man-days lost because of strikes dropped dramatically and as the increased rainfall helped ease infrastructural bottlenecks. For the year as a whole, the rate of inflation was little changed, with wholesale prices on average up a provisional 17.9% in 1980-81, as against a rise of 17.1% in 1979-80. (On a March-to-March basis, the wholesale price increase was 16.4%, compared with 21.4% in 1979-80.) On the external front, a jump in the oil-import bill to $7 billion pushed the trade deficit to an estimated $6.5 billion in 1980-81 from $3.5 billion in 1979-80. The current-account gap widened to approximately $3.5 billion. Despite the receipt of more than $1 billion in funds from the IMF, India's reserves (less gold) dropped to $6.9 billion at yearend 1980, some $500 million below their year-earlier level.

Prospects brighten for Costa Rica's external accounts.

Cost Rica is beginning to reverse the deterioration in its international payments that has proceeded steadily for three years. The country's current-account deficit in fiscal 1979-80 was equivalent to 14% of GDP, compared with 9% of GDP in 1977-78, and gross international reserves totaled only $110 million at the end of February, sufficient to cover just one month's imports. The external-account worsening was principally the result of expansionary fiscal policy and deteriorating terms of trade. The implementation of several measures late last year—including a large devaluation and the imposition of prior import deposits and surcharges—has had some impact. In the first quarter of this year, imports were down 16% from first-quarter 1980, which reduced the trade deficit to $91 million from $118 million last year. Further improvement is possible if the authorities adhere to a new stabilization program within the context of a $300-million IMF extended-facility arrangement.

Latin American nations cooperate on energy.

In an effort to ease the oil import bills and spur energy resource development elsewhere in Latin America, Mexico and Venezuela are currently exporting oil at preferential financial terms to a number of Central American and Caribbean nations. The beneficiaries thus far include Costa Rica, Nicaragua, the Dominican Republic, El Salvador, Panama, Guatemala, Haiti, Belize, and the Bahamas. Each of these countries may purchase 70% of its oil at the prevailing international price, with the remaining 30% taking the form of a five-year loan at a 4% annual interest rate. If the importing country invests this sum in the development of energy resources, the Mexican and Venezuelan governments will lend the outstanding amount out for 20 years at a 2% annual interest rate. For those countries highly dependent on imported petroleum, the balance-of-payments relief can be significant.

North Yemeni economy underpinned by remittances and foreign aid.

The Yemen Arab Republic (North Yemen) is the poorest country in the Arab world, but it has until only recently experienced strong economic growth. Its domestic productive base is dominated by subsistence agriculture, yet incomes have been buoyant because of an average $1.3 billion a year in remittances from one million North Yemenis living in Saudi Arabia and generous Arab aid. The economy experienced a boom between 1976 and 1978, but its external accounts remained in surplus and foreign-exchange reserves were built up to $1.6 billion. More recently, the boom conditions have subsided, with workers' remittances first easing and then declining in 1980. The government has made a concentrated effort to fight poverty by rapidly increasing development spending, and progress has been satisfactory. But the public budget is now in deficit and economic conditions are sluggish. Nonetheless, the economy is underpinned by more than $1 billion in foreign-exchange reserves (seven months' import cover), low external debt, and continued high aid commitments.

The prospect of a large coffee crop weakens prices further.

The world coffee market is characterized by continued sluggishness of demand and plentiful supplies. The crop for the 1980-81 season is projected at 81 million bags, about the same as last season, with total available exports estimated at 60.5 million bags. But the 1981-82 Brazilian crop—whose harvest has already begun—is estimated at 32 million bags, 50% higher than the previous year's crop. Coffee consumption worldwide has grown more slowly than output, and consumption in the United States, the world's largest consuming nation, is no higher today than it was in 1950. The prospect of a large rise in supplies in the face of relatively flat demand has reduced prices to $1.10 a pound, compared with a 1980 peak of $2.02 and a record of $3.40 a pound in 1977. A new international coffee pact, adhered to by 44 exporting countries and 25 importing countries, seeks to keep prices above a minimum of $1.15 per pound by setting export quotas for producers. Exports to pact members were initially limited to 57.4 million bags, but the quota was lowered to 55 million bags as prices fell to their current levels. Despite the coffee agreement's efforts, prices could drop further in the months ahead.

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Budget Outlook Improves

Recent figures on the federal budget have been encouraging. In both of the last two months, the budget has either been in balance or in surplus, on a seasonally adjusted basis. While such favorable results are unlikely to persist, they do suggest that the prospects for a substantially larger fiscal 1981 deficit than that targeted by the Reagan administration—an outcome that seemed probable just a few months ago—have diminished.

The U.S. Treasury recently reported that the budget surplus in April was $17.3 billion. While receipts generally exceed expenditures in April because of the April 15 tax deadline, the monthly surplus still compares favorably with last April's surplus of $9.9 billion and the April 1979 surplus of $11.5 billion. In March, the Treasury reported a monthly deficit of $9.6 billion. But this also compares favorably with last March's deficit of $13.2 billion and the March 1979 deficit of $12.6 billion.

When adjusted for seasonal variation, the 1981 budget figures for March and April actually represent small surpluses. This is in marked contrast to the behavior of the budget figures in the earlier months of the fiscal year, during which the budget was in deficit at an average seasonally adjusted annual rate of more than $80 billion. The seasonally adjusted average for fiscal 1981 through April is now a little less than $60 billion.

These recent figures have led a number of forecasters to revise downward substantially their forecasts of the fiscal 1981 deficit. Most forecasts currently call for a shortfall of only a little more than $60 billion—or moderately above the Reagan administration's current target of $58 billion—compared with consensus forecasts of over $70 billion (and some forecasts of more than $90 billion) just two months ago. Given the relatively strong pattern of federal receipts in May, the May budget figure will probably be consistent with these new estimates.

Most of the recent improvement in the budget deficit is the result of higher-than-expected receipts, rather than lower-than-expected expenditures. This in turn is due at least in part to the faster-than-expected economic growth experienced so far this year. As economic forecasts, then, budget-deficit forecasts can be highly precarious, and are thus subject to sizable revisions even in the short run.

It does appear likely however, that the deficit this fiscal year will be in the $60-$65 billion range. Of course, this is still quite large—and somewhat higher than last year's deficit of $59 billion. Nonetheless, the recent improvement in the budget outlook should be viewed somewhat favorably by the markets in the near term.

Housing Finance Adapting to Change

The thrift industry has come under severe stress over the past three years as interest-rate ceilings have been gradually removed and monetary policy has grown more restrictive. The average return on thrift institution portfolios of long-term assets changed only slowly as new mortgages were written, while the cost of funding these portfolios with short-term deposits soared. Under pressure from the financially troubled industry, the Federal Home Loan Bank Board has issued sweeping new regulations that liberalize the terms under which mutual savings banks and savings and loan associations may issue variable-rate mortgages. Such adjustable-mortgage loans may lighten the burden on the thrift industry, but they may also weaken overall demand for mortgages and keep the housing market in the doldrums.

Under the new regulations, thrift institutions may issue mortgages that have no limit as to the timing or magnitude of interest-rate movements over the life of the mortgage. The rate changes, however, must be tied to some easily verifiable interest rate, such as a specified-maturity Treasury security. Previously, thrifts could adjust the interest rate by one-half of a percentage point, at most, every six months and by 2½ percentage points over the life of the mortgage loan. The lender also has the option of extending the maturity of the loan or increasing the amount of unpaid principal ("negative amortization"), rather than increasing the size of the monthly payment.

The liberalization of regulations is expected to result in an increased supply of funds flowing into mortgages. But the increased variability of interest rates shifts much of the risk from thrifts to individual borrowers, thereby increasing the cost of borrowing. If adjustable-mortgage loans had been available in September 1978, for example, tying the interest payment to six-month Treasury bills would have boosted the average monthly payments by about 34% over the cost of a fixed-rate loan.

This increase in the cost of borrowing will reduce the demand for mortgage funds in two ways: fewer people will qualify for financing, and other downward pressures on house prices will arise in response to the higher borrowing costs. "Creative financings," whereby the home seller holds part of the mortgage at a below-market rate, are becoming an increasingly common way of cutting the total cost of a house. At present, it is impossible to determine whether the increased supply of funds will be more important than the reduced demand in determining the level of mortgage activity.

The move to charge homebuyers market rates of interest and to remove the protection of fixed rates represents a break with the previous policy of actively encouraging homebuying. The change is also consistent with the Reagan administration's attempts to remove market-distorting subsidies and allow market forces to direct the flow of capital into sectors with the highest rate of return.

Asia and Oceania — Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1980		BALANCE OF PAYMENTS					MONEY AND BANKING						COUNTRIES
											12-month changes				exchange rate	change from	
		6 months ending	12-month change	in billions of dollars	per capita	latest data	reserves (less gold) in million $	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	latest data	consumer prices	latest data	money supply(M1)	in U.S. dollars June 3, 1981	year earlier	current monetary conditions	
Bangladesh	Early heavy rains threaten current plantings; Zia assassination clouds overall outlook.	Oct.	+ 6%	13.7*	$ 160	Apr.	260	— 23%	1.5	289	Aid consortium pledges some $1.6 billion for fiscal 1981-82.	Feb.	+10%	Nov.	+15%	.0625	— 7%	Restrictive monetary policy continues under IMF program.	Bangladesh
Burma	Weather conditions favor continued high growth in rice production.	Dec.	+ 15%	5.0*	154	Feb.	262	+ 11%	11.5	33	Rice exports should ensure another balance-of-payments surplus.	Feb.	+ 1%	Sept.'79	+14%	.1450	— 6%	Exchange reserves stable at about $260 million.	Burma
China, People's Republic	Inflation-adjusted growth of 4.5% in national income seen for 1981-82.	Dec.	+ 20%	517.0*	510	Sept.	3,615	+ 13%	2.7	456	Trade figures revised upward to show deficit of $1.3 billion in 1980.	Dec.	+ 8%	n. a.	—	.5750	—15%	Austerity measures in place to reduce inflationary pressures.	China, People's Republic
Hong Kong	Recent jump in share prices injecting some strength into sagging property prices.	Feb.	+ 25%	20.8	4,105	n. a.	—	—	—	—	Exports in first-half 1981 better than expected.	Feb.	+13%	Feb.	+ 9%	.1830	—10%	Interbank rates remain high.	Hong Kong
India	Coal production exceeding target, helping to alleviate infrastructural bottlenecks.	Dec.	— 3%	126.3*	194	Jan.	6,995	— 8%	6.4	319	Higher domestic output and resumed Assam production cutting oil imports.	Feb.	+13%	Nov.	+20%	.1180	— 8%	Sizable budget deficit will preclude reduced money growth.	India
Indonesia	Policies to promote local business interests gain momentum as 1982 elections approach.	July	+ 49%	63.2	417	Mar.	6,145	+147%	8.2	0	Oil, gas earnings dominate; log ban and slack markets hurt other exports.	Mar.	+17%	Nov.	+46%	.0016	0	Rapid money growth may signal rising inflation rate.	Indonesia
Japan	Average wage rise of 7.7%, together with moderation in inflation, should boost consumer spending.	Feb.	+ 32%	1,039.6	8,902	Apr.	26,926	+ 48%	2.2	0	Auto exports to U.S., Canada restricted; EEC seeking restrictions also.	Apr.	+ 5%	Feb.	— 2%	.004465	— 3%	Rate declines reversing with arbitrage, official intervention.	Japan
Korea	Business recovering from slump, led by shipbuilding, textiles, and overseas construction.	Mar.	+ 20%	57.8	1,513	Mar.	2,858	+ 6%	1.4	806	Exports rising strongly, but 1981 current-account gap will top $5 billion.	Mar.	+26%	Feb.	+18%	.0015	—10%	Bank and financial-market liberalization continues slow.	Korea
Malaysia	Business activity in temporary lull, awaiting outcome of general election.	Nov.	+ 8%	22.8	1,659	Feb.	4,206	+ 5%	4.7	0	Slack world demand for commodities depressing exports.	Jan.	+ 7%	Jan.	+21%	.4255	— 9%	Government reiterates desire to keep rates low.	Malaysia
Nepal	Real economic growth of 6%-7% expected in fiscal 1980-81, versus negative 1.5% in 1979-80.	Dec.	— 8%	1.9*	137	Apr.	166	+ 3%	6.1	23	Oil exploration accelerated to reduce oil imports.	Jan.	+12%	Dec.	+13%	.0875	+ 2%	Reduced budget deficit will help curb money growth.	Nepal
Pakistan	Five-year U.S. aid package to include $100 million annually in economic assistance.	Jan.	+ 28%	22.9*	287	Apr.	1,083	+ 22%	2.0	530	Trade and current account deteriorating with relaxation of import restrictions.	Mar.	+15%	Jan.	+17%	.1020	0	Tight monetary policy to continue under IMF program.	Pakistan
Philippines	Continuing recession sharply reduces profits of mining, automotive industry, and other sectors.	Dec.	+ 22%	35.9	750	Apr.	2,526	— 1%	3.5	850	Low prices of sugar, coconut oil, and copper hurting exports.	Mar.	+11%	Feb.	+11%	.1335	0	Most interest-rate ceilings to be lifted July 1.	Philippines
Singapore	Equity and property boom appears to be losing some steam.	Jan.	+ 22%	8.9*	3,790	Jan.	6,636	+ 12%	3.0	0	Softening of export commodity prices widens trade deficit.	Mar.	+ 5%	Dec.	+ 8%	.4645	— 1%	Rates expected to remain high in near term.	Singapore
Sri Lanka	Industrial production increasingly constrained by power cutbacks.	Nov.	+ 3%	3.8	256	Feb.	220	— 53%	1.3	242	Imports slacken as tax-relief provision ends.	Jan.	+24%	Dec.	+22%	.0575	— 8%	Credit controls squeeze lending to private sector.	Sri Lanka
Taiwan	Government considering opening up domestic investment market to greater foreign participation.	Dec.	+ 18%	40.3	2,282	n. a.	—	—	—	—	Recession in principal export markets affects payments outlook.	Feb.	+20%	Jan.	+30%	.0290	0	New foreign entrants intensify competition in banking.	Taiwan
Thailand	Wait-and-see attitude by investors continues in aftermath of coup attempt.	Dec.	+ 12%	27.3*	591	Apr.	1,272	— 26%	1.8	131	First-quarter trade data show unexpectedly large deficit.	Jan.	+16%	Oct.	+14%	.0500	— 1%	Baht depreciated 1% against U.S. dollar.	Thailand
Australia	Federal government scaled back through transfer of operations to states and to private sector.	Dec.	+ 10%	119.1*	8,260	Apr.	2,653	+ 57%	1.0	74	First-quarter 1981 capital inflow was largest on record.	Dec.	+ 9%	Jan.	+12%	1.1380	— 1%	Heavy reserve inflow pushing money growth above target.	Australia
New Zealand	Economy buoyed by start-up of new investment projects.	Jan.	+ 8%	19.6*	6,332	Apr.	372	— 30%	0.9	123	Rapid export price increases will offset slower export volume growth.	Dec.	+16%	Jan.	+10%	.8675	—11%	Low-interest-rate policy spurs money growth.	New Zealand

*1979

World Interest Rates

market rates of June 3, 1981; bond yields as of May 29, 1981

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	14.00 penalty-large banks 18.00	18.66	12.00	14.00	9.50	7.50	19.00 penalty rate 22.00	9.00	5.00	6.25
Day-to-Day Money	19.75 June 4	20.50	11.25	15.00	20.00	12.00	19.75	11.75	6.00	7.00
Treasury Bills 91-day, Middle Rates	15.60	18.70	11.50	16.25	n. a.	n. a.	18.50 85-day	no dealing	no market	5.625 two-month
Commercial Paper prime, 3-month, asked	15.75 finance paper	19.10 finance paper 15% tax w/h	11.36	13.90 Certified	19.00 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	16.35	19.05 15% tax w/h	11.75	13.90 Certified	not traded	9.90	21.35	no market	n. a.	no market
Government Bonds Long-term, new and old issues, average yield	13.05	15.28	13.84	10.24 20% tax w/h	16.89	10.80	19.08	12.02	5.85	8.241
Industrial Bonds prime, long-term, new and old issues, average yield	14.20 Aa Industrials	15.75	14.94	15.70	18.03	11.45	20.41	13.29	6.46	7.14
Bank Short-Term Rate to Best Borrowers (prime rate)	20.00	19.50	13.00	18.75	18.60	14.50	22.50 ⅛ quar'ly fee on outstdng.	13.50	9.50	6.75
Bank Time Deposits 3-month	16.75 Cert. of Dep.	18.70	12.375	16.30	18.875	13.30	10.75	12.00 large deposits	10.00 residents only	4.25 20% tax w/h
Eurocurrencies 3-month, asked	18.375	no market	12.3125	no market	19.75	12.875	no market	11.75	10.1250	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8282	1.9950	.0259	.1789	.4216	.000851	.3799	.4751	.00446
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	.7950 *D*	5.4135 *P*	1.5523 *P*	9.3023 *D*	4.6374 *P*	4.082 *D*	5.698 *P*	7.6956 *P*	9.991 *P*

Eurodollar Deposits
(London, interbank, bid)
June 4

7-day	18.75
1-month	18.75
3-month	18.3125
6-month	17.50

International Arbitrage
(3-month, hedged) *+ in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−1.156
U.S.-Canada Treasury Bills	−1.225
U.S.-Canada Finance Co. Paper	−2.295
Eurodollars-U.K. Local Auth. Deposits	+ .024

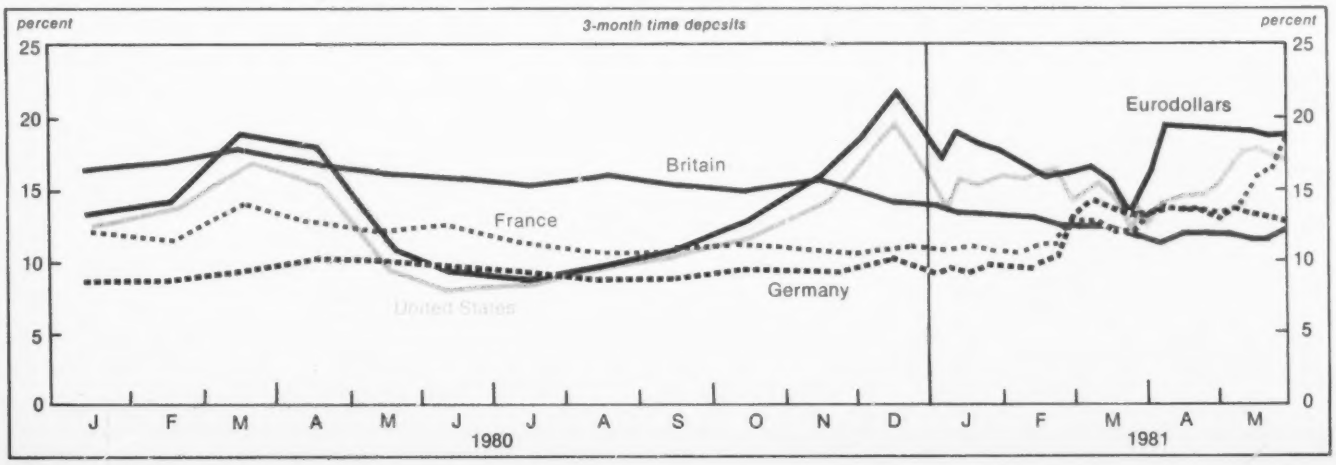
Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	15.50
Over 7 yrs.	15.40
DM Bonds	
7 yrs. and under	11.30
Over 7 yrs.	11.30

Gold Price
London afternoon fixing
475.50
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

Interest rate movements in major industrial countries



Export Credit Subsidies Resist Reduction

Last month's meeting of the 22 member nations of the OECD's Export Credits Group failed once again to achieve a consensus on reducing government subsidization of export credits. The countries now loosely adhering to an international accord that sets minimum interest rates and maximum repayment terms for government-backed export credits were unable to resolve their differences over amending the agreement's interest-rate guidelines. The continuing stalemate has intensified the export credits race, further distorting the world trading system with still higher levels of subsidization.

ARRANGEMENT GUIDELINES

	2-5 year credits	over 5 year credits	maturity limits, years
	(percent per annum)		
Relatively Rich Countries (GNP per capita over $3,000)	8.50	8.75	8½
Intermediate Countries (GNP per capita $1,000-$3,000)	8.00	8.50	8½
Relatively Poor Countries (GNP per capita less than $1,000)	7.50	7.75	10

The lack of progress in the latest round of negotiations comes in the wake of a heavy blow dealt the three-year-old "Arrangement on Officially-Supported Export Credits" in December 1980. At that time, an effort led by the United States and Canada to link interest-rate minimums to some measure of market rates was quashed by European—largely French—opposition. Several proposals were floated at the time, the most prominent of which was a "differentiated rate system". Under this formula, minimum interest rates in each OECD-member country's local currency would be pegged to an average yield on long-term government bonds in each member country. The European nations (the majority of which negotiate through a single European Community spokesman) rejected the notion of market-rate linkage. They countered with an offer simply to boost allowable rate minimums across the board by one percentage point for buyers in rich and intermediate countries, and 0.8 percentage points for customers in less developed countries. The Japanese, who supported the concept of market-tied interest-rate minimums, objected to a uniform rise in Arrangement interest-rate minimums because their domestic interest rates were already below the minimums. The result was a deadlock that has continued to resist resolution.

In the interim, the huge cost of subsidizing the generous export credit programs sponsored by the major industrialized nations has continued to grow more prohibitive as market interest rates have soared. Market rates in some countries are double the minimum interest rates prescribed in the agreement—and widely provided for government-backed export loans (see below). The U.K.'s export credit interest-rate subsidies alone, for example, cost the British treasury some £550 million in fiscal 1980.

	Official export credit rate[1]	Average yield on long-term government bonds (as of May 29)
	(percent per annum)	
United States	8.75	13.05
United Kingdom	7.75	13.84
France	7.75	16.89
Japan	7.75	8.24
Italy	10.10[2]	19.08
Germany	9.50-10.25	10.80
Canada	9.25-10.25	15.28

Further aggravating tensions has been a spate of violations of the export credit pact's terms in the wake of the failure of the December negotiating sessions. The U.S. Export-Import Bank, unable to offer lower rates, exceeded the maturity limits in several export transactions, while at the same time boosting rates nearer market levels. Other nations responded by introducing programs of aid-sweetened export credits for buyers in less-developed countries—so-called "mixed credits". The Canadian government established a C$900-million mixed credit facility, to be used over the next three years, while the British have set aside £2 million in aid funds to be blended with export loans during fiscal 1982 and £4 million for fiscal 1983. The Japanese have also inaugurated a mixed credit program, as have the Swedish and Dutch export credit agencies. Mixed credits, an innovation and long-time practice of the French, do not violate the letter of the export credits agreement as they are excluded from its guidelines. They do, however, violate its spirit as the aid component of such credits typically carries interest rates as low as 3½% per annum and maturities of 25 years. This reduces the overall cost of the already subsidized export credit still further.

Despite its numerous setbacks, however, the beleaguered export credits accord has not actually been repudiated—apparently reflecting its adherents' desires to avoid an all-out export credits war. The United States, which had last fall threatened to renounce the export credit agreement unless its interest-rate mini-

[1] Rates charged by government export credit agencies on their long-term financings of exports to less developed countries.
[2] For lira credits; U.S. dollar credits are frequently offered, at rates of 7.75%.

Export Credit Subsidies Resist Reduction *(continued from page 7)*

mums were linked to market rates, subsequently lost some of its bargaining power through the new U.S. administration's limits on Export-Import Bank funding. The Reagan administration opposes financial subsidies, preferring to focus its pro-export policy on changing U.S. tax, anti-bribery and banking laws. In this context, President Reagan has proposed cutting U.S. Eximbank direct lending authority for fiscal 1981 (ending September) to $5.1 billion. This compares with $5.9 billion requested by the former administration, and represents a decline (in inflation-adjusted terms) from the bank's loan authority in fiscal 1980. For fiscal 1982, the Reagan administration proposes $4.4 billion in Eximbank direct loan authority, as against the $5.0 billion sought by the Carter administration. Meanwhile, Eximbank loan activity is currently limited to honoring only previously made loan commitments under a moratorium in place since mid-February.

Thus, with the U.S. Eximbank's resources cut back and stepped-up subsidies by several other exporting nations, some of the momentum for overhauling the interest-rate terms of the existing export credit agreement has been lost. And several larger influences continue to work against a significant tightening of the guidelines. These include sustained domestic economic sluggishness in many of the industrialized nations, current-account deficits either in evidence or in prospect, and, in general, a long history of strong commitment to maximizing exports in Europe and Japan. Many countries view subsidized export credits as essential to winning export sales, particularly to purchasers in less developed countries. They also favor the status quo because of the rough comparability of national subsidies that has been achieved, but with sufficient leeway for additional non-interest-rate forms of subsidy.

Perhaps the strongest remaining incentive favoring more market-related guidelines is the huge and growing cost of subsidies. Important also is the desirability of easing tensions among the Western industrial nations over trade policy. As for the United States' powers of persuasion, the U.S. Eximbank's occasional practice of exceeding the agreement's repayment terms is a strong bargaining lever. Moreover, it appears as if Congress will restore some of the proposed cuts in Eximbank loan authority.

Possible scenarios

The reality of participants in the export pact adhering to interest-rate guidelines that move automatically in line with market rates in their respective countries seems to be virtually unattainable, so that financial subsidies will undoubtedly persist. Short of that, however, it is feasible that the Arrangement's interest-rate guidelines could still be tightened to reduce subsidy levels. In this regard, several scenarios are possible:

- The European nations could agree to raising minimum interest rates by even more than the one percentage point for the more affluent nations and 0.8 percentage points for buyers in less developed countries. But this will require some resolution to the Japanese problem—either by having the Europeans agree to allow low-interest-rate countries to lend at below the Arrangement minimums if market rates so dictate, or by having low interest-rate countries finance export sales solely through private channels so that the Arrangement guidelines do not apply.

- Another possibility is for the pact's adherents to boost only the minimum rate for buyers in developing countries by 0.8 percentage points (or more)—which would not present a problem for the Japanese whose market rates are roughly comparable—while prohibiting government financial backing for exports to other industrialized nations.

- A third option is to raise the agreement's interest rates to an average market rate based on long-term rates in all of the member nations and adjust the rates periodically—rather than have interest rates move automatically. This option, however, would also pose a problem for countries with lower-than-average market rates.

Speculating on the outcome of the negotiations is, of course, risky, particularly in view of the influence of political variables. The outcome of the French legislative elections later this month, for example, may alter the French bargaining stance, which is a critical one. And trade negotiations proceeding on other fronts will also play an influential role.

But the fundamental issue continues to resist resolution: how to reduce official export financing subsidies without giving countries with low market interest rates too strong an advantage. And the divergence in financial structures and domestic economic priorities—as well as fears over losing market shares in an increasingly competitive environment—is likely to continue to preclude the ratification of a binding accord that will permanently and sharply reduce the level of export credit subsidization. *David M. Cheney*